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The Post Bubble Disorder Investment Roadmap

Recently, we've fielded a number of calls from friends, colleagues, partners, and managements all expressing a heightened level of frustration and concern with the current investment and macroeconomic environments. Many of these conversations center on a longing for the "good old days", when growth companies actually posted earnings and revenue growth, information flowed freely and was discounted fairly efficiently, and annual double digit investment returns seemed a reasonable expectation. Yet intellectually, if not emotionally, most investors realize a return to the go-go days of the late 1990's is highly unlikely any time soon. Which beg the following questions: What should we expect in the period ahead? How should one capitalize on the opportunities that may be presented? And perhaps more to the point, can you generate a return investing in the technology sector in the year(s) ahead?

The hangover from the hyper-growth of the 1990's has created a number of problems for industry participants and investors alike. From a company perspective, the accelerated growth rates of the late 1990's have given way to the tepid growth prospects of the 2000's. Not only was business effectively borrowed from the future but end markets matured while the law of large numbers caught up with yesterday's leadership companies. Capital structures and business models grew to support what at the time were thought to be sustainable growth rates, thus resulting in large companies whose growth prospects today are limited indeed, and ultimately, whose earnings per share leverage have become highly questionable. For the most part, new leadership companies have yet to emerge and technology investors feel mired in an endless transitional period as the great end markets of the last decade- personal computer, cell phone, internet access, and even enterprise software are well penetrated.

This is not to say that opportunities do not exist, they most certainly do. However, one must recognize that very few companies will possess the characteristics of exciting growth prospects; a right-sized business model, and the ability to deliver meaningful earnings per share growth that investors crave.

If investment success in the 1990's was characterized by how much market exposure one was willing to bear, that is, how much "beta" was contained in a portfolio. Success in the early 2000's will be based almost exclusively on stock selection and disaster avoidance, or in other words "alpha", and ability to hedge risk. Furthermore, investment approaches that centered on gathering that incremental piece of information not yet fully discounted into stock prices have been outmoded in a new regulatory world (regulation FD) that actually limits information flow into the marketplace. This decrease in information flow will heighten market inefficiencies, while decreasing day-to-day and intra-day market volatility, but intermediate term market volatility will surely be increased. The practical implication for investors is that short-term market inefficiencies will not be corrected as quickly, meaning that exogenous factors can have a more dramatic near term impact on portfolio positions. Said differently, investors will need to adopt a more patient perspective or run the risk of constantly "chasing their tails".

We believe that investment success in the years ahead will be predicated on early identification of important secular trends that serve to reshape the technology landscape. Encouragingly, we've identified several promising areas of interest. Two of which we have recently written about in Issues I and II of the Hangar 4 Investment Fly-By; *IP Anywhere* and *The Digital Consumer*. A third, emerging RFID infrastructure, could have significant investment impact in 2005 and beyond. We plan on highlighting developments in this arena shortly. These broad-based themes will take a number of years to play out fully, but should provide very attractive investment possibilities for prudent participants. Furthermore, the evolution of technology will continue apace regardless of market environment. Thus, we feel very confident in the opportunities that lie ahead and in the ability to generate a meaningful return over time within the technology sector.

The Hangar 4 Investment Fly-By is a quarterly publication intended to give our partners, and prospective partners, some insight into various themes that factor into our investment posture. Hangar 4 Partners LLC is an equity growth manager focused on technology, consumer product, and service companies. Michael P. De Santis and Bruce M. Lupatkin are the portfolio managers. For information regarding Hangar 4 Partners, please contact Michael P. De Santis, mpd@hangar4partners.com or Bruce M. Lupatkin, bml@hangar4partners.com.